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Nasdaq Order Routing: DTU's Guide for Daytraders

● **Main Points:**

- Once you are with a daytrading broker, you will have many more **choices** as to how you wish to route your order (how you decide to place a buy or sell order to execute your trade). **Learning how to use these different order routing choices is important to your success.** *We've tried to make this the easiest-to-understand visual guide to Nasdaq order routing available.*
- Besides using market and limit orders, **you now have the added flexibility of Who you want to try and buy and sell stock with:** you can trade with specific market makers and use specific ECNs to trade with that you see on your Level 2 screen.
- **There are Two primary ways to route your order: Using the market systems (SOES & Selectnet) and using the ECNs (ISLD ARCA etc.).**
- Most market makers trade on Selectnet, many online trading firms (like Datek) represent buy/sell orders using the various ECNs, eg Datek uses ISLD.
- The major difference between the two: Because trading on the Nasdaq is computerized, **ECN orders get handled instantaneously, but when trading with the market market makers via Selectnet, the mms have a choice as to whether or not they want to trade with you** (and, SOES is mandatory for mms, but as with ecn orders you will be competing with other traders and may not get filled at the price level you want). Overall, trading on ISLD seems to be the fastest and safest way to go. We'll get into the details below.

Notes on using daytrading vs. online discount brokers:

- After learning the basics with a browser-based online broker like Datek, you should get a level 2 service (like esignal) and choose a direct-access daytrading broker like Cybercorp, MBTrading, or others. I would recommend using Datek or another Fast online browser-based broker for your first few months, then switch over to a daytrading broker.
- Many new daytraders go with daytrading brokers from the start, and the speed causes them to spend a fortune in commissions and bad trades, wiping out a lot of their trading capital. Think of it like racing, if you want to be a racer start by driving a sedan first, then migrate to the Formula One racer...if you start with the fastest thing out there you can accelerate your trading losses. During the first 3-6 months, use a reasonably fast online discount broker. If your online broker can't give your order confirmations and fills within 60 seconds on average, though, switch. I made a lot using Datek for well over a year, now I'm with Cyber.
- New traders might want to consider using longer trading timeframes (eg swing/overnight holds) or longer intraday trade times (eg buy at 9:50 sell at 11:30-type trades); you should use a direct-access daytrading broker if you like to scalp within under-20 minute roundtrip type trades (my favorite). If you don't need to have your order filled within a few minutes (because you buy it at 9:50, sell it at 11:30 etc. type trading), there's no reason to spend the extra commission load to get the faster fill time. Just be sure to *a/ways* use limit orders to buy.

Your Order Routing Choices:

MARKET SYSTEMS: (trading directly w/mms)

SelectNet

SOES
(Small Order
Execution System)

OR

ECNs (Electronic Communication Networks): (trading with all traders in the market, including both mms and daytraders)

ISLD (Island)
INCA (Instinet)
ARCA
BTRD
REDI
BRUT
ATTN

Let's look at the differences between these. I've organized a table below showing the rules, when to use, and costs.



	SelectNet	SOES	ECNs
What Is It? How does it work?	SelectNet is the system that market makers use to trade with. You can also trade directly with mms using Selectnet orders. You cannot post bids/offers on Level 2 using Selectnet. There are 2 types of Selectnet orders you can make: BROADCAST: Your order is sent to all market makers simultaneously; they can decide whether or not to trade. Low-priority for mms. PREFERENCE: An order you send to a specific market maker, eg SBSH. Only he sees that bid/ask order you are making. Hi-priority for mms.	SOES is a system that lets traders trade in blocks of 200, 500 or 1000 shares (only), called tiers. SOES executes against mm's without their choice. SOES orders are automatically executed against the market maker, but the order is held in "queue" for 90 seconds. SOES is not used much by daytraders anymore because ECNs are more efficient.	ECNs pair up buy and sell orders and execute them in the order received. The ISLD ECN, used by Datek and many others, is the fastest and most efficient ECN available to trade on, allowing for instant executions. The ISLD book lets you see all the open orders at each price level. ECN's are the most popular way for daytraders to trade. You can trade odd lots easily on ECNs, and they are very liquid, allowing rapid trades. You can also get price improvements if the bid/ask price on the book is better than the one you enter.
Nasdaq's Trading Rules for This System	- Once entered, you cannot cancel Selectnet orders for 10 seconds. - For preferred orders, the mm must respond with an Accept/Decline/Partial to you within 15-30 seconds.	5-minute rule: once you've entered a SOES order you cannot enter another order for the same stock in the same direction (buy or sell) for 5 minutes. But, it resets any time you reverse direction, eg you can buy/sell/buy again within 5 minutes. - SOES can't execute against ECNs. - All SOES orders are done at the inside market.	- ATTN orders must be in the 100's. - You can't send conditional Selectnet orders (eg all-or-none) to ECNs.
Advantages & Disadvantages for Daytraders	ADVANTAGES: You can execute orders outside the market for fast-moving stocks, eg preference a mm who's 2-3 spreads away.	ADVANTAGES: As long as you're first in line, you can usually get a fill at the tier size advertised by the market	ADVANTAGES: Speed and instant executions. Price improvement possible. Liquidity is great. You can play market maker (especially pre- and post-

You can try for price improvement, especially if you are trading in size, since the mm may want to buy without "showing his hand", preferred orders are silent to the market (though the trade will show on the t&s tape).

DISADVANTAGES:

For fast-moving stock the mm's reponse time (up to 30 seconds) can cause trading delays. Main disadvantages are speed and cost, you might get a faster fill at a better price using an ECN.

controlled by the market maker. It's "automatic", like the ECNs, where Selectnet is totally optional.

DISADVANTAGES:

SOES only works on the inside market; you may not get filled, the 5-minute rule.

market) by exploiting the wide spreads (buy at bid, sell at ask).

DISADVANTAGES:

The ECN's don't always have stock in their books at each price levels, where the market makers may have the price you want available. ECN participation varies by stock; some are more heavily traded on ECNs than others.

Costs

Selectnet broadcast: \$2.50

Selectnet preference: \$1.00

Cost: free

Cost: ISLD/NTRD direct: free;

REDI .002/share

BRUT/INCA: .015/share + \$1 if preferred thru Selectnet

ATTN/BTRD/TNTO: .005/share + \$1 if preferred thru Selectnet



Pop Quiz on Order Routing:

Ok here you are trading from the hood of your Mercedes, placing an order to buy 1000 DELL.

You see this level 2 screen, and decide you want to buy your DELL on ISLD.



DELL	-	S3 9/16	b	S3 9/16	a	S3 5/8 20 x 30	36.1M	14:55
MMID	Bid	B.	MMID	Ask	A.			
ISLD	S3 9/16	20	ARCA	S3 5/8	30		S3 9/16	100
INCA	S3 9/16	14	ISLD	S3 5/8	30		S3 5/8	1.00K
ARCA	S3 9/16	10	NTRD	S3 5/8	10		S3 5/8	300
BEST	S3 9/16	10	INCA	S3 11/16	10		S3 9/16	100
NITE	S3 9/16	5	NFSC	S3 11/16	10		S3 5/8	700
MMWSE	S3 1/2	54	NITE	S3 11/16	5		S3 5/8	300
SBSH	S3 1/2	10	REDI	S3 11/16	2		S3 9/16	100
SHWD	S3 1/2	10	PIPR	S3 11/16	1		S3 5/8	1.00K
RAMS	S3 1/2	10	STRD	S3 3/4	214			
DEAN	S3 1/2	10	MLCO	S3 3/4	22			
MSCO	S3 1/2	10	SHWD	S3 3/4	10			
WADF	S3 1/2	2	WARR	S3 3/4	10			
SLKC	S3 7/16	10	SBSH	S3 3/4	7			
DLIP	S3 3/8	10	PERT	S3 3/4	7			

Q1: Which of the following is the only real Market Maker on the inside bid/ask playing with all you ECN traders?

- a) INCA
- b) BEST
- c) ARCA
- d) ISLD

Note: These pop quizzes are the result of a several traders asking "do you have quizzes and tests at DTU?"...so, I'll work them in as I have time.

Q2: Oops, a news story comes out saying DELL has been sued by a group of daytraders because of faulty keyboards (they're not coffee-proof lol). You think all the ECN books will be traded too fast, so you want to preference a market maker to sell outside the market. **Who is the best out-of-the market maker you should try to sell to using a Selectnet preference order?**

- a) SBSH
- b) BTRD
- c) MADF
- d) ISLD

Answers below:

 Quiz answers:

Question 1: Answer is BEST, Bear-Stearns, the rest are ECNs

Question 2: Answer is SBSH, the outside bid market maker with the biggest size.